SECTION 29. (Dissolution Defined.) The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.

SECTION 30. (Partnership not Terminated by Dissolution.) On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.

SECTION 31. (Causes of Dissolution.) Dissolution is caused:

(1) Without violation of the agreement between the partners.

* * * * *

(4) By the death of any partner;

* * * * *

SECTION 37. (Right to Wind Up.) Unless otherwise agreed the partners who have not wrongfully dissolved the partnership or the legal representative of the last surviving partner, not bankrupt, has the right to wind up the partnership affairs; provided, however, that any partner, his legal representative or his assignee, upon cause shown, may obtain winding up by the court.

SECTION 42. (Rights of Retiring or Estate of Deceased Partner When the Business is Continued.) When any partner retires or dies, and the business is continued under any of the conditions set forth in Section 41 (1, 2, 3, 5, 6), or Section 38 (2b), without any settlement of accounts between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such persons or partnership may have the value of his interest at the date

of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership; provided that the creditors of dissolved partnership as against the separate creditors, or the representative of the retired or deceased partner, shall have priority on any claim arising under this section, as provided by Section 41(8) of this Article.

APPENDIX B

25 T. C. No. 24

THE TAX COURT OF THE UNITED STATES

ESTATE OF FRANK H. KNIPP, deceased, HOWARD F. KNIPP, Executor, *Petitioner*;

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

HOWARD F. KNIPP, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Docket Nos. 42545, 50153, 50154.

Filed October 31, 1955.

1. The decedent and petitioner Howard F. Knipp were on the calendar year basis for reporting income, and the partnership, of which they were the sole members with equal rights to share in profits, operated on the basis of a fiscal year ending January 31. The partnership agreement provided, in effect, that if a partner died during a taxable year of the firm his share of the profits would be the amount which he was entitled to receive as "salary". *Held*, that the death of decedent on November 21, 1947, terminated the partnership's taxable year. *Held further*, that one-half of the partnership's profits to the date of death of the decedent, less the amount withdrawn as "salary" is not includible in the gross estate of the decedent as value of a property interest in the earnings of the partnership.

2. The partnership held 11 policies of insurance on the life of the decedent, 10 of which had been assigned to it by the insured. It was the beneficiary of the unassigned policy but the insured had the right to change the named beneficiary. The partnership paid the premiums on all

of the policies. *Held*, that the proceeds of the 10 assigned policies are not includible in gross estate of the decedent under subsections (A) or (B) of section 811(g), I.R.C. of 1939, and that the proceeds of the unassigned policy are a part of the decedent's gross estate under subsection (B).

Randolph E. Paul, Esq., and *Julian N. Stern, Esq.*, for the petitioners.

Paul Waring, Esq., for the respondent.

These consolidated proceedings involve deficiencies in income and estate tax as follows:

Docket No.	*Petitioner*	*Tax*	*Year*	*Deficiency*
42545	Estate of Frank H. Knipp	Estate		$120,980.52
50154	Estate of Frank H. Knipp	Income	1/1/47 to 11/21/47	18,500.36
50153	Howard F. Knipp	Income	1947	351,892.70

Refunds are claimed in Docket Nos. 42545 and 50154.

The issues not conceded on brief or settled by stipulation are:

Docket Nos. 50153 and 50154.

(1) Whether the death of Frank H. Knipp terminated the partnership for income tax purposes.

Docket No. 42545.

(1) Whether the value of the interest of the decedent in the partnership of John C. Knipp & Sons should include the amount of $154,972.05 representing one-half of the partnership income in 1947 prior to his death on November 21, 1947;

(2) Whether the proceeds of certain insurance policies on the life of decedent, totaling $90,512.32, are includible in his gross estate; and

(3) Whether the value of the decedent's interest in the partnership should be reduced by the amount of $4,328.34 as his share of the partnership liability to the United States Maritime Commission for interest as of January 31, 1947.

Findings of Fact.

The facts set forth in the stipulation of facts are so found.

Howard F. Knipp, the petitioner in Docket No. 50153, hereinafter referred to as "Howard", is the executor of the estate of Frank H. Knipp, deceased, his uncle, hereinafter referred to as "Frank", who died testate on November 21, 1947. Howard kept his books and filed his income tax returns for 1947 and 1948 on the calendar year basis. His income tax returns and the estate tax return were filed with the collector of internal revenue for the district of Maryland.

The firm of John C. Knipp & Sons has been engaged in the retail furniture, interior woodwork, and ship-fitting business since 1868. On July 7, 1943, Frank, Howard and John C. Knipp, a brother of Howard, hereinafter referred to as "John", entered into a partnership agreement for the conduct of the firm, hereinafter referred to for convenience as the partnership. Profits and losses of the partnership were to be shared on the basis of 40 per cent to Frank and Howard, and 20 per cent to John. An annual salary of $25,000 each was to be paid to Frank and Howard and $15,000 to John, payable on a monthly basis. Paragraph Eleven of the partnership agreement reads as follows:

> *Eleven.* It is agreed among the partners hereto, anything in this agreement to the contrary notwithstanding, that in the event of any partner's death, the amount to the credit of said deceased partner on the firm's books on February 1, 1943, or on February 1st

in any subsequent year, provided the partnership has run for twelve consecutive months; otherwise the date of settlement shall be as of the prior February 1st, less the amount of his withdrawals over salary, shall be paid to the Executors or Administrators of said deceased partner, and same shall be in full settlement of the deceased partner's interest in said partnership.

The purpose of the provisions was business convenience. The partners had an oral understanding that the capital account of a deceased partner at the start of the fiscal year in which his death occurred would be subject to any adjustments made by the partnership on work completed and reflected in the account.

The agreement did not contain a provision for continuation of the partnership in the event of death of a partner. Under the partnership agreement Frank had no right to share in the partnership earnings for its fiscal year in excess of his contractual drawings unless he survived to the end of the partnership's fiscal year. Similarly, if the partnership income was insufficient to cover the partners' contractual drawings in any year, a partner who died during the year could not be charged with any part of the decrease in net partnership assets and was entitled to his full contractual drawings or "salary."

The partnership kept its books and filed returns on the basis of a fiscal year ending January 31.

John withdrew from the partnership as of August 1, 1945. The settlement agreement entered into with Frank and Howard provided that John's share of profits and losses would be 20 per cent of the profits and losses on contracts outstanding on August 1, 1945, "whether completed, re-negotiated, subject to re-negotiation or in the course of re-negotiation or uncompleted."

On August 1, 1945, the partnership had uncompleted contracts, including contracts with the United States Maritime Commission, hereinafter referred to as "Maritime",

for the fitting of ships, which contracts were subject to renegotiation. On October 30, 1947, Maritime filed a claim against the partnership for $322,461 for progress payments erroneously made for work cancelled on March 8, 1944. The payments were reported in income in the year of receipt. On November 21, 1947, the partnership made a counterclaim for additional amounts due to it for work on ships. The counterclaim was allowed on February 21, 1949, in the amount of $177,733.05 as an offset against the overpayment of $322,461. The balance of $144,727.95 was paid by checks issued in 1949 and 1950 by John C. Knipp & Sons.

After John withdrew from the partnership Frank and Howard continued to operate the business under the partnership agreement of July 7, 1943, except for an oral amendment to provide for an equal division of the profits.

About September 1945 Maritime cancelled further work by the partnership on 10 vessels. Thereafter, the partnership filed a termination claim against Maritime which was still unsettled on November 21, 1947.

In April 1951 "Howard F. Knipp, as partner and as executor of the estate of Frank H. Knipp, deceased partner, and John C. Knipp, as partner, doing business as John C. Knipp & Sons (herein called 'Contractor')" signed a final settlement agreement as of March 6, 1950, with Maritime in respect to a termination claim on the contracts cancelled in 1945. The agreement took into account certain credits to Maritime for supplies which had been taken over by the "Contractor" on the termination of the contracts and progress payments which the "Contractor" had received before the contracts were terminated. In settlement the parties agreed that Maritime had overpaid the "Contractor" by $81,064.09 and that the "Contractor" owed Maritime $16,005.25 for interest on an overpayment made on April 20, 1946, in the amount of $185,560, which overpayment the "Contractor" had repaid in September and October, 1947. The compromise settlement was ap-

proved by the Department of Justice on October 1, 1951. Of the agreed liability for interest, $8,656.67 was for the period to January 31, 1947. Such interest was not claimed as a deduction in the partnership return filed for the year ended January 31, 1947, but was allowed by the respondent as accrued interest in adjusting the net income of the partnership for that period. The amount reported in the estate tax return as the value of Frank's interest in the partnership was not reduced by one-half, or $4,328.34, of such interest of $8,656.67. The capital account of Frank on the books of the partnership was charged as of January 31, 1947, with $4,328.34 for his alleged share of the interest to that date.

On November 21, 1947, the partnership had contracts with Maritime which were subject to profit limitations under the Vinson-Trammel Act. Its work under some of the contracts was completed during the fiscal year ended January 31, 1947. The excessive profits received under the contracts were determined in 1949 or 1950 and were paid by the partnership.

On November 21, 1947, the partnership had unsettled claims for work for Maritime on ships at Savannah, Georgia, and for termination of the contracts as to some of the ships covered by it. The contract price was also subject to adjustment for defective work done after that date. Work on contracts incompleted on November 21, 1947, was continued after that date.

The inventory of the partnership was sold for cash, its machinery and building leased, and its pending contracts assigned to Knipp & Company, a corporation organized on February 1, 1948. The corporation completed the contracts so assigned to it. The partnership bank account was continued after February 1, 1948, in which rental income from a building was deposited.

The capital account of Frank on the books of the partnership had a credit balance of $226,320.90 on January 31, 1947, and $221,845.63 on the date of his death on November

21, 1947. Various entries in the account thereafter reduced the balance to $54,875.96 on January 31, 1949.

The will of Frank provided for cash legacies of $137,000, including $50,000 to Howard, who was named residuary legatee. All of the legacies were paid except the one to Howard. The will provided that if the estate was not sufficient to pay all of the legacies in full, the legacies were to abate proportionately.

At the time of his death on November 24, 1947, Frank had 11 insurance policies of the value of $[illegible]21.32 outstanding on his life, all of which, except one issued by the Sun Life Assurance Company of Canada of the value of $5,000, were assigned to John C. Knipp & Sons in or prior to 1931. The policy issued by the Sun Life Assurance Company of Canada was payable to the partnership. It was assigned to the Baltimore National Bank by Frank and the partnership on May 16, 1939. Under the assignment the bank had "all rights as to the cash surrender values, loans, dividends, and all other handling of policy without consent or signature of the insured". The policy was reassigned on July 31, 1945, by the bank to the partnership. The insured had the right to change the beneficiary at any time prior to his assignment of the policy. The cash value of all of the policies was set up on the books of the partnership as assets and the partnership used the policies as collateral for loans.

The partnership paid the premiums on the policies as they became due. The premiums paid on the policies before and after January 10, 1941, were $56,405.36 and $21,073.35, respectively.

The premiums were considered an expense of the partnership and deducted from gross income except for income tax purposes. None of the premiums was charged to the capital or drawing account of the partners. The increase of cash surrender value of the policies each year was considered income of the partnership, except for income tax purposes, and the value of the insurance as an asset of the partnership was correspondingly increased.

The income of the partnership from February 1, 1947, to the death of Frank on November 21, 1947, was $351,344.09. Included in the amount was $18,887.50 for "salary" actually withdrawn by Frank prior to his death, and $1,812.50 to which he was entitled as "salary" at the time of his death.

The return filed by the partnership for the fiscal year ended January 31, 1947, reported ordinary net income of $309,027.21, distributable in equal amounts to Frank and Howard. The return was signed by Howard.

A partnership return was filed for the fiscal year ended January 31, 1948, showing ordinary net income of $450,158.91, distributable, "In accordance with partnership agreement," $429,458.91 to Howard and $20,700 to the estate of Frank. The return was signed by Howard. A partnership return was also filed for the fiscal year ended January 31, 1949, showing ordinary net income of $11,754.33, all distributable to Howard "In accordance with partnership agreement".

The income tax return of Frank for the period January 1, 1947, to November 21, 1947, reported the amount of $154,513.61 as the decedent's distributive share of the income of the partnership for the fiscal year ended January 31, 1947. Fiduciary income tax returns were filed for the estate of Frank for the period November 21, 1947, to December 31, 1947, and for the calendar year 1948. The return for the period in 1947 reported no partnership income. The return for 1948 reported net income of $25,542.37, including $20,700 of income from the partnership, and tax liability of $8,881.70, which was paid. In his determination of the deficiency against Frank for the period ended November 21, 1947, respondent increased taxable income by the amount of $20,700 for "salary" received from the partnership during the taxable period.

Frank's interest in the partnership was included in his estate tax return at a value of $54,875.96. The 11 life insurance policies of the value of $90,512.32 were reported in the return but not included in the gross estate.

The adjustments made by the respondent in determining the deficiency in estate tax included the following amounts as additions to the net estate:

Increased value partnership's interest	$ 52,848.61
Salary owed by partnership	1,812.50
Partnership income to time of death	[1]84,948.54
Insurance	[2]90,512.32

[1] The parties now agree that the correct amount is $154,972.05.

[2] Included under section 811(g), I.R.C. of 1939, on the ground that the premiums were paid indirectly by the decedent. The parties stipulated that the value was $90,521.32.

In his return for the calendar year 1948 Howard reported income of $405,646.60 from the partnership for the fiscal year ended January 31, 1948. In his determination of the deficiency against Howard for 1947 respondent held that the death of Frank on November 21, 1947, dissolved the partnership and terminated its accounting year as of that date, and, accordingly, included in his income, in addition to his distributive share of the profits of the partnership for the fiscal year ended January 31, 1947, the amount of $330,644.09 representing all of the income of the partnership for the period from February 1, 1947, to November 21, 1947, less $20,700 distributable to Frank, and the amount of $47,087.35 as income from the operation of the business as a sole proprietorship for the remainder of the calendar year 1947.

OPINION.

JOHNSON, *Judge:* Frank and Howard, members of the partnership, reported income on the basis of a calendar year. The partnership's taxable year ended on January 31. Involved in the proceedings relating to income tax is the basic question of whether the death of Frank on November 21, 1947, terminated the partnership and its accounting year for income tax purposes.

Petitioners concede that the death of Frank worked a dissolution of the partnership but, relying primarily on *Heiner* v. *Mellon*, 304 U. S. 271, as to Howard, and distinguishing *Guaranty Trust Co.* v. *Commissioner*, 303 U. S. 493, as to Frank, contend that the firm continued for liquidation purposes without a break in its taxable year until at least January 31, 1948. So arguing, petitioners say that Frank's "salary"[1] of $20,700 and Howard's share of the profits of the business are not taxable until 1948.

Respondent held in his determination of the deficiencies and asserts on brief that the death of Frank terminated the partnership for income tax purposes, with the result that the "salary" of Frank, which the executor of his estate reported as income taxable in 1948, constitutes income taxable for the period January 1, 1947, to November 21, 1947, and that Howard is taxable in 1947 on not only his distributive share of the profits of the partnership to November 21, 1947, but, as sole proprietor, on the earnings of the business for the remainder of the calendar year 1947, contrary to the view of Howard, who included in his return for the calendar year 1948 all of the profits of the partnership for the fiscal year ended January 31, 1948. Respondent says that the *Guaranty Trust Co.* case controls the "salary" question as to Frank, and that that case and paragraph Eleven of the partnership agreement support his position as to Howard.

In *Guaranty Trust Co.*, *supra*, the decedent, who filed his returns on the basis of a calendar year, died on December 16, 1933, while a member of a partnership whose fiscal year ended on July 31. The agreement of copartnership was such that the decedent's death dissolved the partnership, ended his right to share in future profits, and fixed the date for an accounting of earnings by the survivors. Later, the surviving partners formed a new partnership

[1] The partnership agreement classified the amount as salary. For tax purposes the amount constitutes a share of the profits of the business.

and took over the business as of the time of the decedent's death, with a fiscal year ending July 31, 1934, and from year to year thereafter. In January and February 1934, the decedent's executors received the decedent's share of the profits of the firm for the period from August 1, 1933, to December 16, 1933. The executors omitted the profits, so distributed, in the return filed for the decedent for the taxable period ended with his death, and the Commissioner included it in determining the deficiency. No contention was made by the taxpayer that the short period was not a "taxable year" of the partnership within the meaning of section 182(a) of the Revenue Act of 1932, and the Court remarked that if such a contention had been made, it could not have prevailed. The issue before the Court was whether the terms "any taxable year of the partnership ending within his taxable year"[2] appearing in section 182(a), *supra*, precluded inclusion in the income of the decedent for the short period ending with his death, his share of the profits of the partnership for that period, and also the full fiscal year ending on July 31. The Court held that it did not.

In *Heiner* v. *Mellon*, *supra*, one of the three equal partners in two partnerships died in 1919. Liquidation of the business continued thereafter to 1925, when the assets were sold in bulk. No new partnership agreements were entered into by the survivors. The partnership returns filed for 1920 listed the estate of the decedent as a member of the partnerships. The accounting period of the partnerships and the partners was the calendar year. The question was whether the surviving partners were taxable in 1920 on their distributive shares of the partnerships for that year. The Court said that dissolution of the partnerships by the death of one of the partners did not affect the liability of the survivors for tax on their distributive shares

[2] A phrase of like import appears in section 188 of the Internal Revenue Code of 1939.

of the profits in the following year. It then pointed out that:

> * * * Although dissolved, the partnerships and the business continued, since, as stated in the Pennsylvania Uniform Partnership Act: "On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed." * * *

The Commissioner recognizes that the death of a partner does not "in itself" terminate a partnership for income tax purposes; that "Ordinarily, a partnership will be treated as continuing where the business of the partnership, or a substantial portion thereof, is continued," and that the returns of the continuing partnership should be filed on the basis previously established. Rev. Rul. 144, 1953-2 C.B. 212, 213. He does not require application of the ruling to changes occurring prior to January 1, 1954. Rev. Rul. 54-26, 1954-1 C.B. 153. In another ruling, Rev. Rul. 54-55, 1954-1 C.B. 153, with like conditions on retroactivity, the Commissioner held that where the estate of a deceased partner continues the decedent's interest during the winding-up period, the partnership continues during that period of liquidation.

Similar questions have been before this Court. In *Mary D. Walsh*, 7 T.C. 205, where there was no provision for continuation of partnership interests, we held that the death in 1939 of one of the three partners did not affect the taxable year of the partnership as to the surviving partners during the liquidation period.

Dissolution and complete liquidation of a partnership, accounting on a fiscal year basis, occurred within the calendar year 1941 of a partner in *Anne Jacobs*, 7 T.C. 1481, and we held that her distributive share of the profits for the fractional taxable year of the partnership was includible in income for 1941. See also *Louis Karsch*, 8 T.C. 1327.

By prior agreement, the partnership interest of a deceased partner continued in *Estate of Samuel Mnookin*, 12

T.C. 744, affd. 184 F. 2d 89. There, following *Henderson's Estate* v. *Commissioner*, 155 F. 2d 310, reversing 4 T. C. 1001, we held that the accounting period of the partnership did not end with the death on December 1, 1943, of a partner and that the decedent's share of the earnings of the business for the period of it's fiscal year from June 1, 1943, was not includible in his return for the taxable period January 1, 1943, to December 1, 1943. The case was cited in support of the conclusion reached in *Girard Trust Co.* v. *United States*, 182 F. 2d 921, on facts materially the same.

Estate of Isadore Waldman, 15 T. C. 596, revd. 196 F. 2d 83, involved facts similar to the *Mnookin* case. There, under the partnership agreement, the heirs or estate of a deceased partner could elect within 60 days to continue as a partner. The executor made a timely election but the surviving partners rejected it. Thereafter an agreement was reached under which the partnership was dissolved and liquidated as of January 31, 1946, a date within the partnership's fiscal year ending June 30. We held that the death of the decedent on November 22, 1945, did not end the taxable year of the partnership; that such year continued to January 31, 1946, when the partnership terminated, and that no part of the net income of the partnership for the period July 1 to November 22, 1945, was includible in the final return of the decedent for the period January 1 to November 22, 1945.

In *Estate of Joseph E. Tufee*, 20 T. C. 675, affd. 215 F. 2d 78, like in *Estate of Samuel Mnookin*, *supra*, there was an agreement for continuation of the partnership, and we held, following the *Mnookin* case and this Court's ruling in the *Waldman* case, *supra*,[3] that the death of a partner did not terminate the taxable year of the partnership as to him.

The cases before us here involve both the interest of the deceased partner and the sole surviving partner, without an express agreement for continuing the business and an unusual provision as to profits for the partnership tax-

[3] Nonacquiescense withdrawn, 1954-2 C.B. 6.

able year in which a partner should die. The proceeding involving Frank will first be considered.

The partners had a statutory right to select a taxable year for the partnership different from their own, section 188, coupled with a requirement in section 182, *supra*, that their shares of the earnings of the business for the taxable period so selected be included in their individual income tax returns for the taxable year in which the partnership year ended, whether or not distributed. They also had an unrestricted right to agree upon rates of participation in the profits of the enterprise.

The partners here agreed upon withdrawals of profits, designated as salary, at the rate of $25,000 per year for each, payable on a monthly basis. Paragraph Eleven of the partnership agreement expressly provided that upon the death of a partner there should be paid to his estate in full settlement of the decedent's interest the amount to his credit at the beginning of the partnership year, less withdrawals over "salary." The "salary" payable to Frank prior to his death was $20,700, of which $18,887.50 was actually paid to him.

The effect of the agreement of the partners here was to fix the distributive share of a deceased partner in the partnership year in which his death occurred at an amount equal to the "salary" payable to him for the period prior to his death. So limited by express agreement, no right passed from the decedent to his estate to receive any amount for inclusion in a fiduciary income tax return for a subsequent period. See section 126(a)(1)(A), I.R.C. of 1939. The death of Frank eliminated the partnership as a continuing source of income to him as effectively as did the death of the partner in the *Guaranty Trust Co.* case, *supra*.[4] Howard so construed the agreement, as shown by the individual tax return he filed for 1948 in which he reported as taxable to him all of the ordinary net income

[4] See comment of the United States Court of Appeals, Commissioner v. Guaranty Trust Co., 89 F. 2d 693.

of the partnership for its full accounting period, less the $29,700 distributable to Frank before his death.

Frank's death thus not only fixed the date of computation of his distributive share of the profits, but the amount thereof. The amount was earned during Frank's lifetime, and no reason appears for delaying the reporting of such income until the end of an additional period, during which operations could not affect the amount of the share.

While there was no controversy in the *Guaranty Trust Co.* case as to the time of termination of the partnership year,[7] the rationale of the decision there, applied to the peculiar factual situation here, requires a conclusion that the partnership's taxable year as to Frank ended on the date of his death. Accordingly, we sustain the respondent on this point of the issue.

The peculiar facts of the case do not require a different conclusion as to Howard, the surviving partner.

The *Mellon* case, *supra*, is clearly distinguishable. There, the interest of the deceased partner continued with a right of his estate to share equally with the two surviving partners in the profits of the business during the liquidation period of about five years after dissolution. That situation did not prevail here.

Petitioners refer us to various provisions of the Uniform Partnership Act, in force in Maryland, which, they say, required liquidation proceedings and, therefore, a continuation of the business with usual tax consequences until the close of the fiscal year, even though only one partner survived.

We agree that some sort of a proceeding or transaction was necessary to bring about a termination of the partnership as a going business. Complete liquidation of the partnership involved in the *Guaranty Trust Co.* case, *supra*, and, therefore, termination of the taxable year, resulted from the transfer of the business, as of the date of

[7] See Girard Trust Co. v. United States, supra; Estate of Isidore Waldman, supra; and Estate of Joseph E. Tyree, supra.

death of the decedent, to a new partnership organized by the surviving partners. The means employed here were equally as effective to terminate the partnership for income tax purposes as of the date of death of Frank.

The partnership agreement not only gave Howard the right to all profits of the business after the death of Frank, but all of the net income earned prior thereto during the fiscal taxable year selected by the partners, except "salary" distributable to Frank before his death. The agreement was so construed by Howard in reporting partnership income and making return of his and the estate's income, and no contrary contention is being made here by petitioners. The shares of partnership net income to Frank's death were thus determinable under the agreement and continuation of the business was unnecessary to determine distributive shares of partners, since operations could be only for the account of Howard.

Howard was not only entitled to receive all of the net income after Frank's death, but under the partnership agreement concurrently with that event acquired all of the interest of Frank, and with it the assets of the business, for an amount determinable under paragraph Eleven of the instrument. But petitioners point out that Frank's interest was subject to debts of the partnership created while he was a partner. Such obligations would constitute claims against the estate of Frank, and, if allowable, would reduce by a corresponding amount the cost to Howard for Frank's interest. Any rights of creditors against the surviving partner could be pursued against him as the successor of the business.

To conclude, our opinion is that the partnership agreement settled all matters between the partners and terminated the taxable year of the partnership as to Howard at the time of Frank's death. Accordingly, the determination of respondent as to Howard is sustained.

In computing the value of the decedent's partnership interest for inclusion in his gross estate, respondent included an amount as the value of the decedent's share of

the net income of the business for the period of its taxable year ending with his death. The parties agree that if the value should include earnings of Frank from that source, the correct amount is $154,972.05, representing one-half of net income of the partnership for the period, less $20,700 distributable as "salary."

The amount in controversy was not reported in the final income tax return of Frank, and, other than the $20,700, no amount was included by respondent in determining the deficiency. The income tax return of Howard for the calendar year 1948 included an amount for all of the net income of the partnership for the fiscal year ended January 31, 1948, less the $20,700 of earnings distributable to Frank for the period prior to his death. Respondent concedes on brief that Howard, under the partnership agreement, is taxable on all of the earnings for that period, and disagrees with petitioners only on the periods the profits are subject to tax.

While recognizing that the agreement entered into by the partners to determine their distributive shares of the earnings of the business makes the amount taxable to Howard and, therefore none taxable to Frank, respondent's action has placed him in a position of holding, in effect, that Frank had an interest in the earnings as property at the time of his death. He says that the value of the interest at death is not dependent upon the recipient of the earnings, while the gist of petitioners' contention seems to be that if Howard is taxable on the earnings Frank could not have had an interest in them at his death. Respondent says our conclusion is controlled by *Estate of Robert R. Gannon*, 21 T.C. 1073. Petitioners disagree with that case and distinguish it.

The agreement in the *Gannon* case required a valuation of the net assets of the partnership at the beginning of each year and an equal proportionment among the three partners as their investment in the business. Other provisions provided that on the death of a partner the survivors could elect to continue the business or liquidate it.

If continued under the option, the estate of a deceased partner was to receive for the interest of the decedent at his death the amount previously fixed by all of the partners as the value at the beginning of the year; nothing for earnings to the date of death. If the survivors elected to liquidate the business, the estate of a deceased partner was to receive one-third of the proceeds of liquidation. The survivors elected to continue the business and, thereafter, in accordance with the partnership agreement, paid to the estate the sum agreed upon as the value of the decedent's interest at the beginning of the partnership year. Nothing was paid to the estate for profits earned by the business to the date of the decedent's death. Our conclusion under the circumstances was that the decedent's share of the earnings of the partnership for the partnership year prior to his death should be included in the value of the decedent's interest for estate tax purposes. Distinguishable facts are present here.

The two partners in the Knipp partnership saw fit for business convenience to qualify their rights to earnings. If they survived the partnership year, each was to receive one-half of the profits as his distributive share, and if one died during the year, as was the case, his distributive share was, by the occurrence of that event, to be limited to the earnings distributable as "salary." The right to a share of earnings in excess of "salary" was thus wholly contingent upon survival to the end of the accounting period, and until that contingency ceased to exist no partner had a vested interest in profits already earned. Frank never had during the crucial period more than a potential right to profits in excess of the amount designated as salary, and his death prevented that right from maturing. Not being entitled to any part of the $154,972.05 of profits at the time of his death, he had no interest to value for inclusion in his gross estate.

Death of a partner in the *Gannon* case did not, as here, completely destroy an unmatured right to a distributive

share of earnings. Until the surviving partners exercised their option there remained the probability that liquidation would occur with the accompanying right of the estate of the deceased partner to profits. Here, liquidation was mandatory for the benefit of the survivor as to profits. The right of the decedent in the *Gannon* case to earnings was subject to a condition subsequent, and not a condition precedent, as here.

The difference in the facts in these proceedings call for a different conclusion. Accordingly, we find that no amount is includible in the estate of Frank as value for property interest in earnings of the partnership to the date of his death.

Under the settlement agreement entered into in 1951 with Maritime the partnership paid an amount for interest on an overpayment made in 1946. Of the amount paid, $8,656.67 was for interest accrued prior to January 31, 1945. One-half of the amount was charged to Frank's capital account as of January 31, 1947, and was allowed as a deduction by the respondent in determining the net income of the partnership for the year ended on that date. Notwithstanding such recognition of the amount as an accruable expense of the partnership, respondent now says on brief that the amount was not accruable prior to October 1, 1951, the date on which the Attorney General accepted the partnership's offer of settlement and requested payment of the interest, and that as the expense should have been borne in its entirety by Howard under paragraph Eleven of the partnership agreement the value of Frank's interest in the partnership for inclusion in gross estate should be increased by the amount of $4,328.34 charged to his capital account.

The action of respondent in allowing the amount of interest as a deduction in computing the net income of the partnership for the year ended January 31, 1947, infers a determination that liability to pay interest existed at all times after the overpayment was made by Maritime in

April 1946. The liability to pay was sufficient to accrue the interest at the end of the year as a deductible expense. No reason appears, under the circumstances, for not adjusting the capital account of Frank to reflect the accrued liability. Accordingly, we sustain the petitioners on this issue.

At the time of Frank's death the partnership was the beneficiary of 11 policies of insurance on his life, the proceeds of which, amounting to $90,512.32, the respondent included in the decedent's gross estate under the provisions of section 811(g) on the ground that the premiums were paid indirectly by the decedent. On brief respondent relies upon section 811(g)(2), set forth, in part, in the margin,[6] which was included in the Internal Revenue Code of 1939 by section 404(a) of the Revenue Act of 1942. Specifically, he says that proceeds of the insurance are includible in the gross estate of the decedent because the premiums were paid directly or indirectly by the decedent, and that at the time of his death the decedent possessed incidents of ownership exercisable either alone or in conjunction with another person.

The parties agree that all of the policies were assigned to the partnership with the exception of the one issued by the Sun Life Assurance Company of Canada. As to it, respondent says its value is includible in gross estate on an additional ground, namely, that the assured retained

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[6] SEC. 811. Gross Estate.

* * * * * * *

(g) Proceeds of Life Insurance.—

* * * * * * *

(2) Receivable by Other Beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums or other consideration paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. * * *

the right to change the beneficiary. Petitioners' reply to that contention is that the right to change the beneficiary was not retained in the assignment of the policy to the bank and when the bank reassigned the policy to the partnership the latter acquired the right to change the beneficiary.

The assignment to the bank as security for a loan was a contract separate and distinct from the contract of insurance. *New York Life Insurance Co.* v. *Dunlevy*, 214 F. 1, affd. 241 U.S. 518. The partnership, as the designated beneficiary of the policy, had no more than an expectancy under the insurance, which it assigned to the bank, whose economic interest in the policy never exceeded the amount of the partnership's indebtedness to it. The partnership never had the right to change the beneficiary and, therefore, could not assign it. Upon payment of the debt to the bank its interest in the policy ceased and its reassignment to the partnership obviously was merely to transfer such rights as it had received from the partnership as assignee. Never having had a power of appointment over the policy, the partnership received none under the bank's reassignment. In short, the bank's transfer merely placed the parties where they stood before the first assignment was made. As the assured, decedent had the right to change the beneficiary, and that right continued to the time of his death.

The right of decedent to change the beneficiary was an incident of ownership and the proceeds of the policy are includible in gross estate under subsection (B) of section 811(g)(2). *Estate of Judson C. Welliver*, 8 T.C. 165; *Estate of Eugene F. Sexton*, 12 T.C. 569; *Estate of Emil M. Goldblatt*, 16 T.C. 204; *Fried* v. *Granger*, 105 F. Supp. 564, affd. 202 F. 2d 750.

The parties agree that the other 10 policies of insurance constituted assets of the partnership at the time of the decedent's death. Respondent included the proceeds of the insurance in gross estate upon the ground that the

premiums were paid indirectly by the decedent. Such insurance is includible in gross estate under subsection (A) of section 811(g). On brief, while adhering to that view, he asserts that the proceeds are also includible under subsection (B), a provision independent of subsection (A). Petitioner argues that neither of the provisions requires the inclusion of the insurance as property possessed by Frank at his death. Thus, the difference between the parties is whether respondent's determination is sanctioned by either of the subsections.

Petitioner says that the answer to respondent's action under subsection (A) is found in what we said in *Estate of George Herbert Atkins*, 2 T.C. 332. Respondent seeks to distinguish that case upon the ground that it was decided under the statute before the amendment by the Revenue Act of 1942.

The precise question in the *Atkins* case was whether the policies of insurance held by and payable to a partnership on the life of the deceased partner were "taken out by the decedent upon his own life," the premiums having been paid by the partnership. In deciding that question we discussed at considerable length the interest of a partner in firm assets and concluded that the funds used to pay the premiums constituted partnership property and that:

> * * * the decedent did not actually pay, directly or indirectly, any part of the insurance premiums with funds belonging to him. * * * It [the partnership] chose to invest some of its funds in acquiring an asset, viz., the three insurance policies. It had full control over them and all legal incidents of ownership. * * * [p. 342]

So concluding we decided that the insurance was taken out by the partnership rather than by the decedent upon his own life. While the death in that case occurred in September 1939, and the issue was controlled by the stat-

nte then in effect, the conclusion as to the payment of the premiums was reached in the light of the amendment made by section 404 of the Revenue Act of 1942.

The purpose of the provision was to prevent avoidance of the estate tax. H. Rept. No. 2333, 77th Cong., 2d Sess., p. 162; S. Rept. No. 1631, 77th Cong., 2d Sess., p. 235. There is no indication here of a plan to avoid estate tax. To the contrary, the acquisition of the insurance appears to have been nothing more than the purchase of a partnership asset in the ordinary course of business. The funds so used were partnership property and the decedent's interest in the partnership was no more than his share of the profits and surplus, as defined in the partnership agreement. Flack's Ann. Code of Maryland, article 73A, sections 8 and 26.

Respondent quotes, without discussion, from Regulations 105 to the effect that a decedent pays the premiums if payment is made by a corporation which is his alter ego, or by a trust, the income from which is taxable to him. Like statements appear in the Committee reports, *supra*. There is no such similarity here, for Frank's interest in profits never exceeded 50 per cent and Howard had at all times an equal voice as to partnership matters.

No reason appearing for departing from the reasoning of the *Atkins* case, *supra*, on this point, we conclude that the insurance proceeds are not includible in the gross estate under subsection (A).

Respondent relies upon the rationale of *Commissioner* v. *Treganowan*, 183 F. 2d 288, reversing 13 T.C. 159, followed in *Estate of William E. Edmonds*, 16 T.C. 110, and *Estate of Emil M. Goldblatt*, *supra*, to support his present view that the decedent possessed incidents of ownership in the insurance at the time of his death.

In the *Treganowan* case the New York Stock Exchange, of which the decedent was a member at the time of his death, had a plan to pay $20,000 to, in general, the family or heirs of a deceased member. A member's right to desig-

nate a beneficiary under the plan, held to be insurance, was limited to the members of the designated group. The power of a member to sell his seat on the Exchange, with the insurance rights that would go with it, was regarded as sufficient to make him the owner of the insurance for the purposes of subsection (B). In the *Goldblatt* case it was stipulated that the "decedent possessed all of the incidents of ownership in both policies to the date of his death" and, therefore, the question here was not before us for decision.

Respondent concedes that the insurance was an asset of the partnership and that Frank had no rights in the policies other than those flowing from his partnership interest. The inference from such concessions is that Frank, in his individual capacity, had no incidents of ownership in the policies, and respondent cites no specific fact of ownership.

One of the conclusions reached in the *Atkins* case, *supra*, in deciding that the policies of insurance were taken out by the partnership rather than by the decedent there, was that the firm had complete control over them and held all of the incidents of ownership. The material facts here are the same. Nothing in the *Treganowan* case requires a contrary conclusion. Decedent, as an individual, had no power to exercise rights of ownership over the assets and sale of his partnership interest would not have transferred any rights in specific assets of the firm. *United States* v. *Shapiro*, 178 F. 2d 459. Accordingly, we hold that the proceeds of the 10 policies do not constitute assets of Frank's estate.

Decisions will be entered under Rule 50.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7302.

ESTATE OF FRANK H. KNIPP, HOWARD F. KNIPP, EXECUTOR, *Petitioner and Cross-Respondent*, and

HOWARD F. KNIPP and ESTATE OF FRANK H. KNIPP, HOWARD F. KNIPP, EXECUTOR, *Petitioners*,

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent and Cross-Petitioner*, and

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

ON CROSS-PETITIONS TO REVIEW THE DECISIONS OF THE TAX COURT OF THE UNITED STATES.

THIS CAUSE came on to be heard on the transcript of the record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decisions of the said The Tax Court of the United States, in this cause, be, and the same are hereby, affirmed.

April 16, 1957.

SIMON E. SOBELOFF
Circuit Judge, Fourth Circuit.

Filed
Apr 10 1957
R. M. F. WILLIAMS, JR.
Clerk

A true copy,
Teste:

RICHARD M. F. WILLIAMS, JR., *Clerk*,
U. S. Court of Appeals for the
Fourth Circuit.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7302

ESTATE OF FRANK H. KNIPP, HOWARD F. KNIPP, EXECUTOR,
Petitioner and Cross Respondent, and

HOWARD F. KNIPP and ESTATE OF FRANK H. KNIPP, HOWARD F. KNIPP, EXECUTOR, *Petitioners*,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Cross-Petitioner, and

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON CROSS-PETITIONS TO REVIEW THE DECISIONS OF THE TAX COURT OF THE UNITED STATES.

Upon the motion of the attorney for the Estate of Frank H. Knipp and with the consent of the Commissioner of Internal Revenue, the judgment hereinbefore entered on April 10, 1957, is hereby amended to include the following:

"The case of Estate of Frank H. Knipp, Howard F. Knipp, Executor, v. Commissioner of Internal Revenue (Tax Court Docket No. 42545), is remanded, however, in order that the Tax Court may allow proper deductions and redetermine the resultant estate tax liability of the Estate of Frank H. Knipp. For this purpose the Tax Court is further directed to defer its determination of such estate tax liability until the expiration of the time allowed for filing a petition for certiorari, the denial of a petition for certiorari or upon the expiration of thirty days from the date of issuance of a mandate of the Supreme Court in the

cases of Estate of Frank H. Knipp, Howard F. Knipp, Executor, vs. Commissioner of Internal Revenue (Tax Court Docket Nos. 42545 and 50154)."

JOHN J. PARKER
U. S. Circuit Judge.

MORRIS A. SOPER
U. S. Circuit Judge

SIMON E. SOBELOFF
U. S. Circuit Judge

Filed
Apr 30 1957
R. M. F. WILLIAMS, JR.
Clerk

A true copy,
Teste:

RICHARD M. F. WILLIAMS, JR., *Clerk*,
U. S. Court of Appeals for the
Fourth Circuit.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7302.

ESTATE OF FRANK H. KNIPP, HOWARD F. KNIPP, EXECUTOR, *Petitioner and Cross-Respondent*, and
HOWARD F. KNIPP and ESTATE OF FRANK H. KNIPP, HOWARD F. KNIPP, EXECUTOR, *Petitioners*,

versus

COMMISSIONER OF INTERNAL REVENUE, *Respondent and Cross-Petitioner*, and
COMMISSIONER OF INTERNAL REVENUE, *Respondent*

ON CROSS-PETITIONS TO REVIEW THE DECISIONS OF THE TAX COURT OF THE UNITED STATES.

(Argued November 26, 1956. Decided April 10, 1957.)

Before PARKER, Chief Judge, and SOPER and SOBELOFF, Circuit Judges.

Carolyn E. Agger (Paul Weiss, Rifkind Wharton & Garrison, and Julius M. Greisman, on brief) for Petitioners and Cross Respondent, and L. W. Post, Attorney, Department of Justice (Charles K. Rice, Assistant Attorney General; Lee A. Jackson, and Robert M. Anderson, Attorneys, Department of Justice, on brief) for Respondent and Cross-Petitioner.

SOBELOFF, Circuit Judge:

The principal problem of this case relates to the proper time for taxing partnership income earned in the year of the death of one of the partners.

A partnership is not a taxable entity under our internal revenue laws, but it has a taxable year for accounting purposes and is required to make an information return, which becomes the basis for computing the partners' individual income. As the partnership fiscal year may be different from that of the individual partners, the law (U. S. Internal Revenue Code of 1939, Sec. 188, 26 U.S.C.A. Sec. 188) undertakes to deal specifically with this situation. The controversy here hinges upon the proper application of this section, which provides that where the partnership taxable (fiscal) year is different from that of the individual partner, he shall include in the net income for his taxable year his share of the partnership net income for any partnership taxable year which ends during his individual tax year.[1]

In the instant case the partnership had a fiscal year ending January 31, while the partners were on the calendar year basis. Hence, for a number of years, by the operation of Section 188, the individual partners paid income tax on their respective shares of partnership income only for that partnership year which closed during the calendar year. Thus, in reporting 1946 income, each partner included his share of partnership income for the fiscal year which began February 1, 1945, and ended January 31, 1946. Partnership income earned during the remaining eleven months of 1946 pertained to the fiscal year ending January 31, 1947,

[1] "If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner. 53 Stat. 71." (26 U.S.C.A. Sec. 188)

and was reported in the individual returns for the calendar year 1947.

Our decision is required as to whether, as the Commissioner of Internal Revenue contends, the death of a partner on November 21, 1947, terminated the partnership for income tax purposes as of that date so as to make taxable as 1947 income the partners' respective shares of partnership income which accrued from February 1, 1947, to November 21, 1947. The alternative treatment, for which the taxpayers are here striving, is that the partnership should be deemed to have continued for income tax purposes, despite the partner's death on November 21, 1947, until February 1, 1948, the end of the normal partnership fiscal year. In that case, the income should be taxed as 1948 income.

For many years the firm of John C. Knipp and Sons had been engaged in the business of retail furniture, interior woodwork, and shipfitting. Since 1945 the business had been conducted by two partners, Howard F. Knipp and his uncle, Frank H. Knipp; and by the partnership agreement, each made a regular monthly withdrawal, which was called "salary," at the rate of $25,000.00 annually. Profits over and above salary, as well as losses, were shared equally, but were not distributed until the conclusion of the partnership's fiscal year the following January 31.

A highly important provision of the partnership agreement, paragraph 11,[2] required that to become entitled to

[2] "*Eleven.* It is agreed among the partners hereto, anything in this agreement to the contrary notwithstanding, that in the event of any partner's death, the amount to the credit of said deceased partner on the firm's books on February 1, 1943, or on February 1st in any subsequent year, provided the partnership has run for twelve consecutive months; otherwise the date of settlement shall be as of the prior February 1st, less the amount of his withdrawals over salary, shall be paid to the Executors or Administrators of said deceased partner, and same shall be in full settlement of the deceased partner's interest in said partnership." (Agreement of Co-Partnership between Frank H. Knipp, Howard F. Knipp and John C. Knipp, July 7, 1943.)

share in any fiscal year's profits, a partner must have survived the end of that year. On the death of a partner, he and his estate would have no right to any part of the profits of the current fiscal year beyond the amount of salary paid or due him up to the time of his death. Settlement of his interest in the partnership assets was to be made by reference to the capital accounts as of the February 1 prior to death. It is necessary to note the effect of this unique provision, whereby a partner lost all participation not only in profits accruing after his death, but even in such profits as had been earned during the portion of the fiscal year in which he lived and contributed to the business.

On November 21, 1947, Frank Knipp died, thereby terminating his and his estate's interest in partnership profits earned since the preceding January 31, except the $20,700.00 of salary which had been paid or become due him before his death. Frank's capital account as of the end of the last fiscal year preceding his death (January 31, 1947) had a credit balance of $226,320.90. This was subsequently reduced to $54,875.96 by May 19, 1949, when his estate tax return was filed. The reduction was occasioned by settlement and renegotiation of certain government contracts. These renegotiations had begun prior to Frank's death.

When the usual partnership information return had been duly filed for the fiscal year ending January 31, 1947, it showed a net income of $309,027.21 distributable in equal shares to Frank and Howard. The individual tax return for Frank's 1947 income (filed by his executor) included Frank's one-half share of this sum, $154,513.61. It did not, however, include the $20,700.00 which he received as salary from February 1, 1947, until his death. This amount was reported instead as 1948 income, on the theory that the partnership fiscal year continued, despite Frank's death, until January 31, 1948. The Commissioner, asserting that the partnership tax year was terminated by Frank's death, determined a deficiency for 1947, designating the salary of $20,700.00 as 1947, rather than 1948, income.

Similarly, Howard filed his return, reporting as 1947 income only his share of the partnership income for the fiscal year ending January 31, 1947. The entire partnership profits earned between February 1, 1947, and November 21, 1947, to which Howard alone was entitled (less $20,700.00 salary for Frank), and all income from November 21 to December 31, as well, were not reported until the following year, when they were returned as 1948 income. As with Frank, the Commissioner determined a deficiency in Howard's 1947 taxes, on the theory that by the operation of paragraph 11, Frank's death terminated the partnership tax year, and all income of the business from January 31, 1947, to the end of the calendar year was taxable to Howard as 1947, and not as 1948, income.

The law is authoritatively declared for us in *Guaranty Trust Co.* vs. *Commissioner*, 303 U.S. 492. Paragraph 11 of the Knipp partnership agreement makes the analogy between the two cases a close one.

In the *Guaranty Trust* case, the partnership was on a fiscal year basis ending July 31, while the deceased partner was on a calendar year basis. After his death on December 16, 1933, the trust company, his executor, making its return for the decedent's 1933 income, included his share of the firm profits accruing to the end of the fiscal year on July 31, 1933, but omitted his share of the firm profits earned between that date and his death. The Commissioner determined a deficiency by adding to the 1933 taxable income the decedent's share of firm profits between July 31 and December 16, 1933.

The basis of the Supreme Court's decision that the Commissioner's determination was correct was that both by the practical construction given to the partnership agreement by petitioner and the surviving partners, and by the applicable provisions of the New York Partnership Act, decedent's death dissolved the partnership, terminated his right to share in the profits, and fixed the date as of which the surviving partners were bound to account for profits.

The Supreme Court held that the Congressional purpose was to make taxable in the individual taxpayer's year all income distributable to him during that year. A pertinent lesson of that case is that "receipt of income or accrual of the right to receive it within the tax year is the test of taxability." *Guaranty Trust Co.* vs. *Commissioner*, supra, p. 498. Earlier, in the Court of Appeals for the Second Circuit, which likewise decided the case for the Commissioner, Judge Chase had said (89 F. 2d 692, 693): "The accounting whenever it took place was as of that date [the death]. That was when, in contemplation of law, his share of the profits became distributable." In neither Court was the fact that the accounting was not completed until the following calendar year treated as material. We cannot escape the clear effect of the decision in the *Guaranty Trust* case that termination of sharing in profits was for the purposes of the income tax law a termination of the partnership tax year.

In the instant case, the same result is required by paragraph 11 of the partnership agreement. By its command, the partnership, as far as participation in income was concerned, ceased to exist. By virtue of Frank's death, Howard received all profits from partnership transactions, not only with respect to business yet to be completed during the winding-up period, but indeed, even profits on completed transactions dating back as far as January 31, 1947.

The petitioners think it significant that in *Guaranty Trust*, the surviving partners undertook to form a new partnership after the decedent's death, to take effect retroactively as of the date of his death. Here, Howard formed a corporation that took over the business as of January 31, 1948; but in the intervening period, from November 21, 1947, to January 31, 1948, paragraph 11 of the partnership articles created the same result as in the *Guaranty Trust* by completely immunizing the decedent's estate from all operations, whether resulting in profits or losses. The fact that in *Guaranty Trust*, the succession was by a number

of partners, while here it was by one individual, does not distinguish the cases. The significant fact common to both cases is that the partnership fiscal year ended when the decedent's estate no longer had its capital at risk, to be affected by gains or losses from the operation of the business.

In no true sense can it be said that after Frank's death, Howard was winding up the business of the partnership; he was operating on his own, and Frank's estate had nothing at stake. The income tax law is concerned merely with income, and inasmuch as sharing of profits had ceased, the partnership had effectually terminated in the eyes of the tax law.

We are not dealing here with the normal situation where the decedent partner continues during the winding-up period to share in profits accruing from outstanding transactions. See note, 80 A.L.R. 15, 32. Under generally recognized local law, there is such a sharing of partnership profits where the partners have made no other agreement; but nothing precludes their making such an arrangement as was made here. The Uniform Partnership Act, which is in effect in Maryland, Article 73A, Flack's Annotated Code of Maryland, was in effect in New York when the *Guaranty Trust* case arose and was referred to in that opinion; yet its provisions, which include the distinction normally to be observed between dissolution and termination, were not deemed in the circumstances to prevent termination of the partnership tax year at the time of the death. Where the partners have not substituted their own arrangement, and the deceased partner's interest continues to be subject to pending transactions, the law recognizes that ordinarily, there is good reason for allowing the tax year to continue after dissolution and until its normal conclusion, unless sooner terminated by a complete winding-up of the firm. In the present circumstances there is no reason for the distinction between dissolution and termination, at least as far as the income tax law is concerned.

The Government advances the additional argument that one cannot be a partner with himself and that, for this reason, too, the partnership year terminated as of Frank's death. We agree with the taxpayer that this argument draws an unnatural distinction between cases where a single partner survives and where there are more than one survivor. We have shown that under the Uniform Partnership Act, a single survivor may, as to unfinished business, be a partner with the decedent; and in an appropriate case the partnership will, under a legal fiction, be deemed to continue. The distinction to be made here, however, is that the parties specifically agreed not to be partners as to income arising after Frank's death; and the same result would seem to follow from such an agreement where there is only one survivor, no less than if there were more than one. Here the parties negatived any post-mortem partnership; none is required by the necessities of the situation; nor will the Uniform Partnership Act impose it.

But, it is insisted, the pending negotiations, begun before Frank's death but completed later, might have affected not only the capital accounts of the partners as of January 31, 1947, as they indeed did, but they might also have wiped them out, and affected the income of Frank which had been paid or was due him in the form of withdrawals. This contention, however, must fail, for it is directly contrary to a clear and indisputable finding of fact made by the Tax Court in construing the written agreement and oral understandings. The decedent's withdrawals, according to the finding, were not to be affected by outstanding partnership debts; for ". . . if the partnership income was insufficient to cover the partners' contractual drawings in any year, a partner who died during the year could not be charged with any part of the decrease in net partnership assets, and was entitled to his full contractual drawings or 'salary.'"

If Frank's share was fixed, it follows that Howard's was, too. Howard was entitled to all the profits of the business arising after January 31, 1947. While the exact amount

might be subject to computation and might not be free from uncertainty by reason of pending renegotiations, he was no less certain as to the amount of his income in the year 1947 than any business man similarly engaged in business as an individual. Every taxpayer in a going business must compute his profits at the end of the tax year, since the scheme of the statute contemplates annual returns and the taxation of annual income, although it necessarily involves estimates in some instances which may require correction at a later time.

Decisions in several circuits have been cited to us as supporting a contrary view. *Henderson's Estate* vs. *Commissioner*, 5 Cir., 155 F. 2d 310; *Girard Trust Co.* vs. *U.S.*, 3 Cir., 182 F. 2d 921; *Commissioner* vs. *Mnookin's Estate*, 8 Cir., 184 F. 2d 89. These, however, turned on facts negatived here. They disclose the converse of the arrangement between the Knipps, because in those cases there was a continuation of the sharing of partnership income after the death of a partner. The two situations are so different as to require a difference in result. This was recognized in *Girard Trust Co.* vs. *U. S.*, 3 Cir., 182 F. 2d 921, a case chiefly relied on by the taxpayers. The opinion, by Judge Hastie, contains, at page 924, this significant language: "If there is no agreement for continuation upon the death of a partner, and if distributive shares are determined and allotted as of that date, the partnership has established an abbreviated accounting period coterminous with the life of the deceased partner." Even where the deceased partner's estate continued to share in profits for a short period after his death, the Court of Appeals for the Second Circuit felt constrained to follow the *Guaranty Trust* decision. *Commissioner* vs. *Waldman's Estate*, 2 Cir., 196 F. 2d 83.

Reliance is placed, also, upon the decision in *Heiner* vs. *Mellon*, 304 U.S. 271. We think such reliance misconceived. In that case, two corporations in the whiskey business had begun liquidation in 1918. The three stockholders, upon assignment to them of the corporate assets, took over the

liquidation as partners. One of them, Frick, died in December, 1919. The question before the Supreme Court was whether profits distributed to the surviving partners, the Mellon brothers, in 1920, the year after Frick's death, should be taxed in that year, or not until the liquidation had been completed. The Mellons argued that in a liquidation, one could never be certain before its termination whether it would finally result in a profit or a loss. The liquidation in fact continued till 1925. It was held that the business of the partnership was liquidation, and the Mellon brothers had to pay taxes on the profits each year as realized. The question there was not whether a tax year terminated upon the death of a partner, and it is significant that the Supreme Court did not think this was the point involved, for it did not ever refer to the *Guaranty Trust* case, which adjudicated such an issue less than two months earlier.

We have been referred to certain new statutory provisions in the Internal Revenue Code of 1954, Section 706(c), as having some indirect bearing on the case before us. The suggestion is made that this new provision, that death shall not end the taxable year of the partnership, was merely declaratory of the old law. With this, however, we cannot agree. "Bunching" of more than a year's income in a single tax year was, indeed, sought to be eliminated by Section 706(c). True, the Senate Committee Report (see U. S. Code, Congressional and Administrative News, 1954, p. 4723) does not explicitly treat bunching as permitted under the 1939 Internal Revenue Code, which controls this case. The report speaks in uncertain terms of such a "contention" being made. It cannot, however, be inferred from this alone that the Senate regarded the new Code as merely declaratory of the old law. The House Committee Report, on the other hand, plainly evidences the opinion that the new statute was not merely declaratory, but designed to effect a change in the law. It recites:

> "Under present law the death of a partner may result in the closing of the partnership year and the bunching

of more than a year's income in the decedent's last year. Where the partnership and the partners are on different taxable years, this rule may have the effect of concentrating as much as twenty-three months' income in the final return of the deceased partner, that is, the income for the partnership year ending within his taxable year and the income for the taxable year closed by the partner's death. The bill provides relief in this situation by preventing the partnership year from closing on the death of the partner. The partnership year will then run to its normal conclusion, and the decedent's share of the income for such year will be taxable to the estate." (See U.S. Code, Congressional and Administrative News, 1954, p. 4093.)

It is not within our province to give retroactive effect to the 1954 Act.

We have fully considered Mr. Justice Stone's observation in the *Guaranty Trust Company* case, that if the income in question were not taxable in 1933, it would not be taxable at all. It was proposed to us in argument that since the law was later changed to prevent escape from taxation,[3] the result here should not be controlled by *Guaranty Trust*. The suggestion cannot prevail for two reasons: first, because this feature of the old law was merely noted in passing and was not the basis of the Court's opinion in the *Guaranty Trust* case, as shown in the foregoing discussion and as recognized in *Commissioner* vs. *Waldman's Estate*, supra, 85; second, because it attributes to the Supreme Court a purpose to revise rather than interpret the income tax laws.

The argument that bunching income works a hardship in this case is the same as the one overruled in the *Guaranty Trust* case. Moreover, were the hardship of bunching a pertinent consideration, it would be mitigated by the fact that for a number of years, these taxpayers had the ad-

[3] Sec. 42(a), Internal Revenue Act of 1934, as amended in 1942; and also Sec. 126 of the Internal Revenue Act of 1942.

vantage of paying their taxes almost a year late because the partnership fiscal year deferred taxes on eleven months of firm profits until the following year. Fundamentally, the hardship here results from the fact that Howard's income was greater in 1947 than in 1948. If his 1948 income exceeded that of 1947, the rule for which he now contends would work to his disadvantage. We cannot be certain which interpretation of this statute will, in the long run, be more helpful to the Government, and which to the taxpayer. Even if we had a discretion in the matter, this should admonish us against letting the interpretation of a statute turn on a purely fortuitous circumstance; for in straining to avoid hardship here, we may make ourselves responsible for inflicting hardship upon future litigants. We are bound, in any event, by the *Guaranty Trust* case, and have no power to revise the law to meet the supposed equities of particular cases.

II

A second issue, raised by the Government's appeal, relates to computation of Frank's gross estate for estate tax purposes. The Tax Court held that the share of firm profits, above "salary," which Frank would have received for the period January 31, 1947, to November 21, 1947, had he lived, was not includable in his gross estate under Section 811(a) of the Internal Revenue Code of 1939. The Commissioner seeks reversal of this decision, reasoning that these profits constituted property of Frank at his death and passed to Howard by the partnership agreement as a testamentary disposition.

We are, however, unable to accept this reasoning, and agree with the decision of the Tax Court. The Commissioner's contention sharply conflicts with the plain and practical effect of the articles of partnership, which required a partner to live to the end of the partnership tax year in order to acquire any interest in the year's profits. Sharing, beyond accrued salary, was clearly dependent

upon survivorship, and unless this contingency was satisfied, a partner had no vested right in any part of the profits for any portion of the fiscal year. As the Tax Court correctly observed, the right to share was potential only and did not mature till the end of the tax year, if the partner was then living. In view of this, we do not think it would be correct to say that Frank, at the time of his death, possessed any share in the firm profits includable in his gross estate.

Accordingly, we uphold the decisions of the Tax Court upon both questions.

Affirmed

PARKER, Chief Judge, Dissenting in Part:

I agree with that part of the decision of the Court which relates to the estate tax, but respectfully dissent from its holding that the earnings of the partnership were taxable as income to the partners for the year 1947, and not at the end of the partnership's fiscal year in 1948. Sec. 188 of the Revenue Code of 1939, which is the section applicable here, provides:

> "If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner."

The death of Frank on November 21, 1947, unquestionably dissolved the partnership. The question is whether it also terminated the partnership for all purposes, so that the fiscal year of the partnership ended with Frank's death, or whether the partnership was continued for the purpose of

winding up its affairs, so that its fiscal year for tax purposes did not end until January 31, 1948.

The facts are that the partnership was engaged in the performance of contracts which extended over considerable periods of time and, in the case of contracts with the government, were subject to termination and to renegotiation. Frank's capital account on January 31, 1947, to his credit on the books of the partnership, amounted to $226,320.90. As a result of negotiations with the government extending to as late as October 1951 and resulting in refunds and disallowances of claims, this balance was reduced to $54,875.96. On February 1, 1948 the business and assets of the partnership were transferred to and taken over by a corporation; but there can be no question but that the partnership business was continued and the settlement of its affairs was carried on by Howard as surviving partner until that date. On January 31, 1948, the partnership filed a tax return showing ordinary net income of $450,158.91, distributable in accordance with the partnership agreement* $429,458.91 to Howard and $20,700 (salary prior to death) to the estate of Frank. The contention of taxpayers is that under the statute above quoted this income was taxable to them for the year 1948. The contention of the Commissioner is that the partnership was ended for all purposes on Frank's death in 1947 and that the income of the partnership after January 31, 1947 was taxable to the partners in that year, notwithstanding that it will result in the injustice of requiring them to pay tax on partnership income for ap-

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*The applicable provision of the partnership agreement is as follows:

"*Eleven.* It is agreed among the partners hereto, anything in this agreement to the contrary notwithstanding, that in the event of any partner's death, the amount to the credit of said deceased partner on the firm's books on February 1, 1943, or on February 1 in any subsequent year, provided the partnership has run for twelve consecutive months; otherwise the date of settlement shall be as of the prior February 1, less the amount of his withdrawals over salary, shall be paid to the executors or administrators of said deceased partner, and same shall be in full settlement of the deceased partner's interest in said partnership."

proximately 22 months in a single year. The position of taxpayers not only is in accordance with what is just and right under the circumstances of the case, but is also, I think, in accordance with the statutory requirement.

While the partnership agreement contained no provision for the continuance of the partnership business for purposes of liquidation in the case of the death of one of the partners, this was unquestionably provided by the law of Maryland, the state in which the partnership was operating. It is there expressly provided by statute that the death of a partner dissolves the partnership, but that the partnership is not terminated by dissolution but continues until the winding up of partnership affairs is completed, and that the last surviving partner has the right to wind up the partnership affairs. Flack's Annotated Code of Maryland, Article 73A secs. 30, 31 and 37. Here, not only did the law authorize the continuance of the partnership for the purpose of winding up partnership affairs, but the partnership was actually continued for that purpose until its business and assets were transferred to a corporation on February 1, 1948. In the meantime, although the deceased partner could not share in profits, it is perfectly clear that his share of the partnership profits could not be ascertained until the end of its fiscal year because of claims that might be asserted and adjustments and settlements that would have to be made and were made with customers and creditors. The importance of this clearly appears from the fact that Frank's capital account on the books of the partnership shrank as a result of claims against the partnership and negotiations and adjustments from $226,320.90 on January 31, 1947 to $54,895.96 when these matters were finally closed up sometime after his death. If the claims had been sufficiently large, they could have wiped out, not only the capital account, but all right to receive anything as profits from the earnings of the current fiscal year.* In such situation it was

* If the profits had been wiped out, the "salary" paid Frank would have been paid, not from profits, but from capital. 1 Montgomery's Federal Taxes 1294.

not possible, at the time of Frank's death, to determine what the earnings of the partnership were, and no reason why the rule of the statute should not be applied, i.e. no reason why returns of income derived from the partnership should not be made by the partners on the basis of the partnership's fiscal year, even though the partnership had been dissolved and was in process of liquidation during the last two months of the year.

In point is the decision of the Supreme Court in *Heiner v. Mellon*, 304 U. S. 271. In that case it was held that the death of one of the partners, which dissolved the partnership before the tax year in question, did not terminate the partnership or relieve it from filing a return. It is true that in that case the estate of the deceased partner shared in the profits of the continuing business; but the criterion laid down by the Supreme Court was not the sharing of profits but the continuing of the partnership business, as here, until the winding up of the partnership affairs. The Supreme Court referred to the statute of Pennsylvania which is like the statute of Maryland in that regard, saying:

> "The fact that the partnerships had been dissolved by Frick's death before 1920 does not affect the liability of the Mellons as surviving partners for income taxes on their distributive shares of the net profits made in that year. Compare Rossmoore v. Anderson, 1 F. Supp. 35 (S.D. N.Y.), affirmed, 67 F. 2d 1009 (CCA2); Rossmore v. Commissioner, 76 F. 2d 520 (CCA2). The business of A. Overholt & Company did not terminate on Frick's death. Although dissolved, the partnerships and the business continued, since, as stated in the Pennsylvania Uniform Partnership Act: 'On dissolution the partnership is not terminated, but continues until the winding up of the partnership affairs is completed.' Throughout the year 1920, the business of selling stock on hand and deriving income therefrom was carried on precisely as it had been theretofore, and for the same purpose. Article 424 of Regulations 45

recognizes that even in the hands of a receiver a partnership must file a return."

The Commissioner relies, and the Tax Court bases its decision very largely on *Guaranty Trust Co.* v. *Com'r*, 303 U.S. 493, which held that the return for a deceased partner on the calendar year basis must include his share of partnership profits made by the partnership from the beginning of its fiscal year to the time of his death within the calendar year. In that case, however, there was not a continuing of the partnership business for purposes of liquidation, but the amount to be received by the estate of decedent was fixed and the business was carried on under a new agreement. The question in the case was whether the decedent's share of the earnings for the portion of the fiscal year prior to his death was to escape taxation,* not whether it should be taxed in the succeeding calendar year. In that case the Supreme Court said "Receipt of income or accrual of the right to receive it within the tax year is the test of taxability, not the time it has taken the taxpayer to earn it nor the duration of his investments which have finally resulted in profit." Here the right of taxpayers to receive income in connection with the partnership business did not accrue or become fixed upon Frank's death but depended upon the partnership business, which was continued for purposes of liquidation.

A decision of the Tax Court which is directly in point and which sustains the position that the earnings of the partnership here involved should be taxed in 1948, the end of the partnership's fiscal year, and not in 1947 because

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*A loophole in the tax law which was closed by the subsequent enactment of Sec. 126 of Title 26 of the U.S. Code, which provides:

"The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is required by the decedent's estate from the decedent; * * *."

Frank died in that year, is *Walsh* v. *Commissioner* 7 T. C. 205, in which the Tax Court gave full consideration to both the Mellon and the Guaranty Trust cases. In that case one of the partners in a partnership with a fiscal year ending May 31 died on July 7, 1939. It was held that the surviving partner who reported on a calendar year basis should account for profits of the partnership in the year 1940, and not in 1939, on the ground that the partnership, although dissolved by the death of the partners, was not terminated and no new partnership was created. The Tax Court said:

> "The evidence here is clear that after Elliott's death there were no new partnerships created. Although the old partnerships were dissolved by Elliott's death, they were not terminated. Dial v. Martin (Tex. Civ. App.), 37 S. W. 2d 166, 177. The business being conducted by the partnerships had to be wound up by the surviving partners and an accounting made to the heirs and personal representatives of the deceased partner. Dial v. Martin, supra. In that case the court, among other things said: 'Where a partnership is dissolved by the death of one of the partners, the surviving partner or partners have the right, and, moreover, it is their duty, to wind up the firm's business, and he is, in the eyes of the law, a trustee of the firm assets for that purpose, and as such trustee is entitled to the exclusive possession of all firm assets. * * *.'
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> "To the same effect as above is Heiner v. Mellon, 304 U.S. 271. This case was decided by the Supreme Court some forty-eight days after it decided Guaranty Trust Co. of New York, supra, and in our opinion, throws more light on the issue which we have here to decide than does the Guaranty Trust Co. case."

The rulings of the Internal Revenue Service have been in accord with the principles of this decision,* although not

* These rulings provide in part as follows:

"Rev. Rul. 144, 1953-2 Cum. Bull. 212, 213: Accordingly, it is held that a change in the membership of a partnership resulting from the death, withdrawal, substitution, or, addition of a partner, or a shift of interests among existing partners does not, in itself, effect a termination of a partnership for Federal income tax purposes. Ordinarily, a partnership will be treated as continuing where the business of the partnership, or a substantial portion thereof, is continued. The returns of a continuing partnership should continue to be filed on the basis of the annual accounting period previously established by the partnership.

"Rev. Rul. 54-26, 1954-1 Cum. Bul. 153: Rev. Rul. 144, C.B. 1953-2, 212, revoked O.D. 228, C.B. 1, 190 (1919) and holds that a change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a partner or a shift of interest among existing partners does not, in itself, effect a termination of a partnership for Federal income tax purposes. Rev. Rul. 144 also holds that a partnership's basis in its assets is distinct from the partners' bases in their partnership interest, and is not affected by changes in such partnership interests. However, the bases of the interests of the partners may be affected by any change in membership.

"In view of the fact that Revenue Ruling 144 was not published until August 3, 1953 the Internal Revenue Service, under the authority of section 3791(b) of the Internal Revenue Code, will not require the provisions of that Revenue Ruling to be applied with respect to those changes in partnership interests which occurred prior to January 1, 1954.

"Rev. Rule 54-55, 1954-1 Cum. Bull. 153-154: Effect of the death of a partner in the case of a partnership consisting of only two partners. Advice is requested whether Rev. Rul. 144, C.B. 1953-2, 212, holding that a change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a partner or a shift of interests among existing partners does not, in itself effect a termination of a partnership for Federal income tax purposes, applies to a case where one of two partners dies.

"In some cases the surviving partner and the estate of the deceased partner continue the business as a partnership within the meaning of section 3797(a)(2) of the Internal Revenue Code. In this situation the rule of Rev. Rul. 144 is applicable.

"In other cases the partnership business is wound up over a period of time and the deceased partner's estate continues decedent's interest in the profits and losses of the business during the winding-up period. In this situation the partnership continues

dealing with the case of a two member partnership which is continued after the death of one of the partners solely for the purpose of winding up and without participation in profits of such continued operation by the estate of the deceased partner. The Commissioner contends that there is a difference between the case where there are two or more surviving partners and where there is only one; but there is no basis in reason for such a distinction, just as there is no basis in reason for holding that there must be a sharing in profits from the continuation of the business for the purpose of winding it up. The statute contemplates that the partners shall account for partnership income in their returns as though it were received by them at the end of the partnership's tax year; and what makes the rule applicable notwithstanding the death of a partner is, not the number of partners nor the extent to which they do or do not share in profits, but the fact that the partnership business continues, even though this is only for purposes of liquidation, and that the interest of surviving partners may be affected thereby, even though this may be the result of claims, losses and adjustments without right to share in profits. Not until the end of the fiscal year of the partnership can it be determined what its earnings and profits for the year were; and not until then is there any reason for requiring a

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throughout such period. See Heiner v. Paul Mellon et al., 304 U. S. 271, Ct. D. 1345, C.B. 1938-1, 349.

In other cases the surviving partner, pursuant to an obligation undertaken in the partnership agreement, purchases the decedent's interest in the partnership from the decedent's estate for an amount fixed or determinable as of the date of decedent's death. In this situation the partnership terminates for Federal income tax purposes on the date of decedent's death.

"Since this Revenue Ruling applies the principles stated in Rev. Rul. 144 to the facts herein, it will be given nonretroactive application to the same extent as Rev. Rul. 144, and accordingly, pursuant to the authority contained in section 3791(b) of the Code, the Internal Revenue Service will not require this Revenue Ruling to be applied with respect to those changes in partnership interests which occurred prior to January 1, 1954. See Rev. Rul. 54-26, page 153, this Bulletin."

partner or the estate of a deceased partner to list as income his share of the partnership profits.

The government admits in argument that if there were more than one surviving partner, the rule contended for by taxpayers would be applicable, arguing that no man can be a partner with himself. This, however, is an oversimplification of the problem. The partnership is unquestionably dissolved by the death of one of the partners. The business is continued by the surviving partner, however, under the applicable statute for purposes of liquidation; and tax liability of partners, like other matters of business affecting the partnership, should be handled just as they were before dissolution. This is the sensible interpretation of the statute and it avoids the injustice to the taxpayer which would result from the bunching of income for a longer period within a single tax year.

The decisions in all of the Circuits which have dealt with the question, except the Second Circuit, support the position here taken. *Henderson's Estate* v. *Commissioner* 5 Cir. 155 F. 2d 310; *Girard Trust Co.* v. *United States* 3 Cir. 182 F. 2d 921; *Commissioner of Internal Revenue* v. *Mnookin's Estate* 8 Cir. 184 F. 2d 98; *Commissioner of Internal Revenue* v. *Tyree's Estate* 10 Cir. 215 F. 2d 78, 80. *Cf. Commissioner of Internal Revenue* v. *Waldman's Estate* 2 Cir. 196 F. 2d 83, in which there was a dissenting opinion by Judge Augustus N. Hand, who thought that the reasoning of the Third Circuit in the case of Girard Trust Co, supra should be followed. The case of *Commissioner* v. *Tyree's Estate*, supra, is directly in point here, the holding being that income from a partnership dissolved by the death of one of the partners was not returnable by the partners until the year in which the fiscal year of the partnership ended, where the law of Utah as well as the partnership agreement required that the partnership be continued after the death of a partner for the purpose of winding up its affairs. The court said:

> "Of course, when the doctor died he could no longer be a partner and, so far as he was concerned, the part-

nership terminated, but he had, however, agreed as to how the partnership affairs should be handled in case of the death of a partner. The Utah General Partnership Act provides that 'On dissolution a partnership is not terminated, but continues until the winding up of partnership affairs is completed.' 5 U.C.A. 1953, sec. 48-1-27. Pantages v. Arge, 1 Utah 2d 105, 262 P. 2d 745. The partnership affairs were continued as provided for in the agreement, and at the end of the first fiscal year after the death of Dr. Tyree, a distribution was made to his estate. Had he lived, the distribution would have been made at the same time.

"The Commissioner urges that the decision of the Tax Court is not in harmony with Guaranty Trust Co. of New York v. Commissioner, 303 U. S. 493, 58 S. Ct. 673, 82 L. Ed. 975, as was pointed out by the Second Circuit in Commissioner v. Waldman's Estate, 196 F. 2d 83. We do not believe, however, that the Guaranty Trust Company case is controlling. There, the partnership was concluded with the death of a partner and if subsequent partnership distributions were not included in the return made for the deceased, it would not be taxable. Section 126(a)(1) was passed shortly after the Guaranty Trust Company decision, and appears to have been for the purpose of closing the loophole in the tax laws pointed out in that case. The identical question before us has been considered by the Third, Fifth, and Eighth Circuits, which have held contrary to the contention of the Commissioner here. Henderson's Estate v. Commissioner of Internal Revenue, 5 Cir. 155 F. 2d 310, 164 A.L.R. 1030; Girard Trust Company v. United States, 3 Cir. 182 F. 2d 921; Commissioner of Internal Revenue v. Mnookin's Estate, 8 Cir. 184 F. 2d 89. Substantially all of the Commissioner's arguments here are fully answered in the Girard Trust Company case, to which views we adhere."

The Internal Revenue Code of 1954 makes it clear that as to cases governed by its provisions "the taxable year of a partnership shall not close as the result of the death of a partner" (26 USC 706(c)(1)); but this was not intended as a change but as a clarification of existing law. In the Senate Finance Committee's report on the code it is said (S. Report No. 1622 on H. R. 8300, 83rd Cong. 2d Sess. p. 89, 91):

> "Under present law there has been the contention that the death of a partner closes the partnership year and the bunching of more than a year's income in the decedent's last year. Where the partnership and the partners are on different taxable years, this would have the effect of concentrating as much as 23 months' income in the final return of the deceased partner * * *. Both the House and your committee's bill make it clear that the partnership year does not close upon the death of the partner. The partnership year will run to its normal conclusion, and the decedent's share of the income for this year will be taxable to the estate. To the extent that the right to receive this income constitutes income in respect of a decedent, the estate is entitled to a deduction for estate tax attributable to the inclusion in the decedent's estate."

For the reasons stated, it seems clear that the partnership was continued for the purpose of winding up its affairs until January 31, 1948, and that the share of the income to which Howard was entitled subsequent to January 31, 1947 was properly reported by him as income of the year 1948. I think that the same is true as to the partnership income to be reported by the estate of Frank. While it is true that the amounts received by Frank were received from the partnership as salary in 1947 prior to his death, the rule applies that partners' salaries and interest paid between the close of the partnership's fiscal year and the partners' individual tax periods should not be reported by individuals until the partnership's full year has elapsed. (Thompson,

18 B.T.A. 1192(A). The partnership might have a net loss for the year, and in this event the salary would not be income, but a withdrawal of capital. 1 Montgomery's Federal Taxes 1294 (1951 52). The rule applicable is thus stated by the Tax Court:

> "An agreement between partners to pay salaries from profits is nothing more than the determination of a basis for dividing such profits. A partner devoting his time and energies to the business of the firm is in fact working for himself and cannot be considered as an employee of the firm in the sense that he is in the service of another. It follows, therefore, that he can not be paid a salary by the firm out of earnings in the sense of compensation for services rendered to an employer. In effect any allowances drawn by a partner from partnership assets are payments which he makes to himself and no man can be his own employer or employee. A partner receiving a salary is merely transferring money from one to another of his own pockets." Estate of S. V. Tilton et al., 8 B.T.A. 914, 916.

To same effect: *Appeal of J. H. Goadby Mills* 3 B.T.A. 1245; *Melville v. Thompson* 18 B.T.A. 1192(A).

I would accordingly reverse the decision of the Tax Court to the effect that the earnings of the partnership were taxable as income to the partners for the year 1947 and not at the end of the partnership's fiscal year in 1948. The injustice and hardship of requiring taxpayers to pay tax on partnership income for 22 months in a single year is obvious. Their position that partnership income for the fiscal year ending in 1948 should be taxable to them in that year, accords, in my opinion, with the reasonable interpretation of the applicable statute. Such interpretation not only avoids injustice and hardship in this case, but recognizes a rule which is just and right in any case where a partnership is dissolved by the death of a partner but its business is continued by the survivor or survivors for the purpose of winding up its affairs.